

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:FSH:BOS:TL-N-5767-00
MJGormley

date:

to: Taxpayer Advocate Service, Andover IRS Center
Attn: Jacqueline A. Edwards, Customer Service, EOSCO

from: Associate Area Counsel, (LMSB) Area 1

subject:

GATT Interest Computations

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This is in response to your request for advice regarding the applicability of the GATT amendment's reduction in the rate of interest on corporate overpayments to the portion of a refund due to [REDACTED], for the period ending [REDACTED].

ISSUE

Whether the GATT amendment's reduction in the rate of interest applicable to the excess portion of corporate overpayments, as defined in I.R.C. § 6621(a), applies only to the excess portion of the overpayment outstanding on January 1, 1995, the effective date of the amendment, or also to the interest accrued on this excess portion prior to January 1, 1995.

CONCLUSION

The reduced rate of interest under GATT applies to both the excess portion of the underpayment and the interest that has accrued on the excess portion under pre-GATT law.

FACTS

On [REDACTED], the Service issued a refund of \$ [REDACTED] to the taxpayer. This refund consisted of an overassessment of \$ [REDACTED], plus allowable interest of \$ [REDACTED]. The Service computed allowable interest on the overassessment, \$ [REDACTED], and all allowable interest accrued up to that date using the reduced corporate overpayment rate found in I.R.C. § 6621(a)(1). Allowable interest was computed on the first \$10,000.00 of the overassessment at the regular overpayment rate.

The taxpayer has filed a request with your office for a recomputation of the interest as previously calculated. The taxpayer alleges the Service erred when it included allowable interest accrued through December 31, 1994 in the portion of the refund to which the reduced rate of interest under I.R.C. § 6621(a)(1) applies.

LEGAL ANALYSIS

Generally, interest is allowed and paid on any overpayment at the overpayment rate established under I.R.C. § 6621. I.R.C. § 6611(a). The General Agreement on Tariffs and Trade ("GATT"), enacted in 1994¹, changed the interest rate on corporate overpayments. In accordance with this amendment, for periods after December 31, 1994, interest accrues on the first \$10,000.00

¹ See Uruguay Round Agreements Act, Pub. L. No. 103-465, section 713 (1994).

of the overpayment at the federal short-term rate, plus two percentage points (2%). Interest accrues on the excess of the overpayment over \$10,000.00 at the federal short-term rate, plus one-half of one percentage point ($\frac{1}{2}\%$) ("the GATT rate"). In computing the amount of any interest to be paid, interest is compounded daily. I.R.C. § 6622(a). This means that interest is calculated at the end of each day and the resulting interest is treated as principal for the following day's interest calculation. The result is that overpayment interest is computed each day on the sum of the overpayment of tax and the overpayment interest that accrued the previous day.²

The taxpayer has noted that I.R.C. § 6621(a)(1) calls for application of a lower allowable interest rate "to the extent that an overpayment of tax [emphasis added] by a corporation....exceeds \$10,000....". The taxpayer relies on the absence of a similar provision in the Code directing the Service to apply this lower interest rate to allowable interest that accrues on an overpayment prior to January 1, 1995 as support for its argument that the lower overpayment rate should not be applied to allowable accrued interest through December 31, 1994, the effective date of the amendment. The Service has already considered and rejected this argument in an Acknowledged Significant Service Center Advice ("SCA") dated June 18, 1998. See SCA 1998-014.

In this acknowledged significant advice, the Service initially analyzed the proper application of the GATT rate without regard to the effective date of the statute. It found that because I.R.C. § 6622 requires interest on overpayments to be compounded daily, each day when calculating interest on overpayments, there is no distinction drawn between the overpayment of tax and the prior accrued interest. Both the overpayment and the accrued interest, the full debt, are used to calculate the additional interest accrual. As a result of this compounding rule, the regular overpayment rate will apply to the tax and additions overpaid as of January 1, 1995, plus all accrued interest on that overpayment. If, as taxpayer has argued, the I.R.C. § 6621(a) is interpreted to mean that the \$10,000 GATT rate relates only to an overpayment of tax and not the overpayment's accrued interest, the result would be contrary to the daily compounding requirements of I.R.C. § 6622.

After determining the proper application of the GATT rate, the SCA went on to analyze whether there was any legal

² Section 6622 was added by Pub. L. No. 97-248 (1982), section 344(a).

justification for different treatment of interest accrued before the effective date of the GATT amendment and interest accrued thereafter. No justification was found. Specifically, there was no support in the statute or the legislative history for different treatment of accrued interest based on the dates of the accruals. Further, it was noted that the effective date provision states only that the rates apply for determining interest for periods after December 31, 1994. P.L. 103-465, section 713(a).³ It was found that the effective date was tied solely to the accrual period of interest and not when the overpayment arose or the period to which the overpayment related. "This application of the rate to periods after 1994 belies an intent for it to be applied to different amounts of taxes and interest depending on whether they arose before or after January 1, 1995." SCA 1998-014.

At the time of the Service Center Advisory and at the present time, there are no court cases that directly address the GATT interest issue. There are however a series of cases in which the courts considered a similar issue relating to underpayments and the effective date of TEFRA. The SCA relied on the legal analysis found in these four opinions in which the courts considered whether I.R.C. § 6622's interest compounding requirement applied only to underpayments outstanding on the effective date of TEFRA (January 1, 1983) or also to simple interest that had accrued prior to the effective date. In each of the cases, the court agreed with the Service that the requirement of compounding applied not only to the underlying underpayment, but also to the simple interest that accrued on the underpayment prior to the effective date of TEFRA. See RJR Nabisco, Inc. v. U.S., 955 F.2d 1457 (11th Cir. 1992); Purer v. U.S., 872 F.2d 277 (9th Cir. 1989); Cohn v. U.S., 872 F.2d 533 (2nd Cir. 1989), cert. denied, 493 U.S. 848 (1989); Garnet v. U.S., 877 F.2d 965, 968 (Fed. Cir. 1989).

Conclusion

³ It was noted that the application was more specifically described in the legislative history. "The provision is effective for purposes of determining interest for periods after December 31, 1994, regardless of the taxable period (if any) to which the underlying tax may relate." H.R. Rept. No. 103-826, p. 178.

Based on all of the above, the Service concluded, and we agree, no distinction should be drawn between the portion of an overpayment in excess of \$10,000.00 and the interest accrued thereon. We note that the Significant Advice referred to herein has been acknowledged and may be cited to the taxpayer. If we can be of further assistance in this matter, please contact Michele J. Gormley of this office at 617/565-7858.

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By: _____

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